

ABSTRACT

Software and methodology for active account management using volatility
arbitrage is described. The software and method of the invention identify differences between
5 the volatility of an index and the volatilities of the constituents of that index, that is, the
dispersion, and harvests or extracts those differences in the form of premiums. A method
comprises establishing tracking baskets populated with component equities which satisfy
prescribed criteria, such as possessing a high degree of correlation to the underlying index, a
predetermined volatility differential relative to the underlying index, or both. The tracking
10 basket is then dynamically hedged using options. In another aspect of the invention, methods and
software are provided for the selection of options to dynamically hedge the trading basket.